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FM AMEMBASSY ABUJA
TO RUEHC/SECSTATE WASHDC PRIORITY 4711
INFO RUEATRS/DEPT OF TREASURY WASHDC PRIORITY
RUEHOS/AMCONSUL LAGOS 0461
RUEHZK/ECOWAS COLLECTIVE
RUCPDOC/DEPT OF COMMERCE WASHDC

UNCLAS SECTION 01 OF 02 ABUJA 002437

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E.O. 12958: N/A
TAGS: EFIN ECON EINV ETRD PGOV NI
SUBJECT: NIGERIA: CENTRAL BANK MOVES TO STABILIZE NAIRA

REF: ABUJA 2387

¶1. (SBU) Summary. The recent depreciation of Nigerian naira, against the U.S. dollar has led to a change in policy by the Central Bank of Nigeria (CBN). The Monetary Policy Committee (MPC) met on December 11 and the CBN issued new policy guidelines aimed at stabilizing the value of the naira. The new policies are - the CBN will meet all foreign exchange demand in the inter-bank foreign exchange market based on market determined rates five days a week; and the reduction in the foreign exchange net holding of banks from 20% to 10%. The reduction in foreign exchange holding is to further tighten up oversight by the CBN of Nigerian banks. The CBN expects these actions will stabilize the foreign exchange market and renew confidence in the naira. End Summary.

¶2. (U) On December 11, 2008, the CBN's MPC met to discuss the naira's depreciation from 117 naira to one U.S dollar to 130/134 naira to one U.S. dollar since December 1 (reftel). This is sharp contrast to the naira's substantial gains against the dollar since 2004 and relatively stable from 2006 to 2008.
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MPC Changes Policy

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¶3. (SBU) The MPC decided that the CBN would participate actively in the daily inter-bank foreign exchange market by buying and selling foreign exchange in order to meet demand for foreign exchange that had recently significantly outstripped the supply of foreign exchange. Also the MPC agreed that starting from December 15, banks' foreign exchange net position will be reduced from 20% to 10% of shareholders' funds. (Note: The net position is the amount of foreign exchange banks are allowed to carry in their books. This is approved for each bank by the Trade and Exchange Department of the CBN, and the basis of calculation is the shareholders' fund of each bank. Thus each bank has a unique net position approved for it. End Note). Contacts have noted that the CBN was not properly regulating the banks and ensuring they held to the 20% regulation.

¶4. (U) After the MPC meeting, CBN Governor Charles Soludo told the media that the MPC acknowledged the anxiety of participants in the foreign exchange market and wanted to assure the public that the CBN remains committed to a stable exchange rate and will continue to meet the demand for foreign exchange at market determined rates. This he noted was already being achieved as the CBN met $1.34 billion of the $1.4 billion demanded in the inter-bank market on December 11. This is in contrast to the situation since November 28, 2008, where the CBN was only meeting a little above $150 million of the more than $1 billion demand on the twice weekly openings of the Wholesale Dutch Auction System (WDAS)(reftel).

¶5. (SBU) Ayo Teriba, CEO Economic Associates noted that the naira's depreciation coincided with President Yar'Adua's announcement of a deficit budget on December 2, which sparked a panic in the economy

and created a crisis of confidence for the naira. He said there is little the CBN or the Ministry of Finance can do to mitigate the naira's slide because the 1.09 trillion naira ($8.26 billion) deficit undermines the CBN's ability to defend the currency in the coming year as oil prices continue to drop. Bismarck Rewane, CEO Financial Derivates agreed with Teriba, saying the terms of trade have turned against Nigeria, as the country's export declines and imports continue to rise. According to Rewane, the new guidelines contain several contradictions - the CBN's proposal to defend the naira is contradicted by its failure to increase the interest rate from its current level of 9.75 percent; and the claim to intervene daily in the foreign exchange market is undermined by dwindling foreign reserves.

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New Moves May Stabilize Naira

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¶6. (SBU) Comment: The decision by the CBN to also participate actively in the daily inter-bank foreign exchange market and meet the demand for foreign exchange will likely slow the naira's depreciation to the dollar. Concomitantly, a reduction in the foreign exchange net open position of Nigerian banks might lead to a reduction in the demand for foreign exchange. However, the CBN can supervise the banks more effectively by making sure that the banks' demand for foreign exchange does not exceed their approved foreign exchange net open position. The recent increase in foreign exchange demand might not be unconnected with the inability of the CBN to enforce the previous foreign exchange net position rule. End Comment.

¶7. (U) This message was coordinated with ConGen Lagos.

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